V. FINANCIAL FEASIBILITY OF FOUR PROTOTYPE MIXED-USE PROJECTS

This Chapter presents an analysis of the financial feasibility of four prototypical mixed-use development projects, one in each of the four Westside cities. The Chapter begins with a summary of the financial feasibility computer model used in the analysis, which is an adaption of a model developed by The Natelson Company, Inc., for use in evaluating mixed-use projects in the City of Los Angeles. The Chapter then describes the four prototypical projects and how city-specific zoning and other regulations were applied to each prototype, including a graphic depiction of each prototype. Next, the feasibility results for each prototype are reported, under a baseline case, and for each of several possible changes that reflect factors within the control of the cites.

A. THE FINANCIAL FEASIBILITY MODEL

The City of Los Angeles' Mixed-Use Financial Model. The City of Los Angeles City Planning Department's new draft General Plan Framework places significant emphasis on the ability of mixed-use development projects that include housing to accommodate projected growth in the City's housing supply. In conjunction with the preparation of the Framework and its Draft Environmental Impact Report, the City has been studying various amendments to its existing, and rather cumbersome conditional use permit for mixed-use projects in order to make it more useful for the role envisioned for mixed-use development in the Framework. Accordingly, The Natelson Company, Inc. prepared an economic impact and financial feasibility model to assist City staff and the Framework consulting team to better understand the effects of market dynamics and regulatory and entitlement constraints on mixed-use project feasibility.

The model was applied exclusively to conditions in Community Plan areas in Los Angeles, using 15 very general prototypical mixed-use developments. The prototypes were three to six stories above grade with one to two and one-half levels of parking. They ranged in size from approximately 20,000 to 120,000 square feet, including one and two-story commercial space below a mix of studio, one- and two-bedroom apartments.

Description of the Los Angeles Feasibility Model. The model is a series of linked spreadsheets that have been supplemented with user-friendly "help" keys. To test the feasibility of a mixed-use project, the user enters specific project characteristics, including the following:

- lot description, zoning and land use mix
- density/building area, setbacks and lot coverage

- parking, open space and recreational amenities
- development fees and costs
- operating and financial assumptions
- government incentives, reductions, waivers or exactions

All of the inputs, or assumptions, are incorporated into a project cash flow analysis, from which feasibility is determined. By manipulating key variables among the project characteristics, one can identify the extent to which a change in a particular variable impacts feasibility.

Key variables include:

- land cost
- rent
- density
- parking
- proportion of deed-restricted affordable housing
- discretionary permit processing time

For example, by establishing a minimum threshold rate of return necessary to attract private sector investment, the model can be used to determine the minimum (relative to rent and density) and maximum (relative to land costs, parking, affordable housing and processing time) threshold levels of any key variable that can be supported by a project, based on a particular mix of project characteristics.

Conclusions of the Los Angeles Model Runs. The following is a summary of what the consultants concluded about the conditions that lead to feasible mixed-use projects in the City of Los Angeles, based on analysis of the prototypes. "Feasibility" was measured in terms of internal return on investment (IRR), for which the minimum acceptable threshold was established to be 12 percent.

- *Projects Are Not Feasible Where Land Costs and Achievable Rents Are Out of Balance.* IRRs were unacceptably low for prototypes in Community Plan Areas where increases in land costs had significantly outpaced increases in commercial and residential rents (e.g., parts of the Westside). Similarly, IRRs were unacceptably low in communities where rents were too low, in spite of low land costs.

- *Reducing Parking Requirements Boosts Feasibility.* IRRs increased for projects when the parking requirement and, therefore, development costs, were reduced. The rationale for doing so was proximity to mass transit or the presence of affordable housing.

- *A Greater Proportion of Commercial Space in a Project Generally Correlates With Higher Returns.* IRRs were greater for projects with a larger proportionate share of commercial FAR, because commercial space usually generates a higher return than residential space. As a result, the FAR required to achieve a target IRR will be higher if both commercial space and housing are added to a project than if just commercial space is added. [The model assumed, however, that there existed sufficient demand for whatever amount of commercial space was modeled. As the case studies prepared for this Report show, this is not always a valid assumption.]

- *Permit Processing Delays Hurt Returns.* IRRs decreased as the time required to obtain entitlements increased, particularly among projects with the highest IRRs. These include larger projects and projects with a larger share of commercial space. The model assumed a six month processing time and an equity investment in land only, upon commencement of the entitlement process. Interest costs were not assumed to be incurred on the equity investment during the entitlement period. [Greater decreases in IRR would result during delays in processing time if the equity investment is increased to reflect: (a) all pre-development costs to date; and (b) the interest on or "opportunity cost" of equity capital during that delay time.]

- *Returns Are Sensitive to the Proportion to Affordable Housing Requirements.* IRRs decreased as the proportion of price-restricted affordable housing in the prototype increased.

- *An FAR of 2.0 is the minimum for Feasibility.* The analysis suggested that a Floor Area Ratio (FAR) of 2.0 (i.e., building floor area equal to twice the area of the site) is the minimum necessary for feasibility because this allows sufficient

flexibility in the design to accommodate a reasonable land use mix. However, from a practical marketing and feasibility perspective, the project site area used in the calculation of FAR must be larger than a single standard size parcel.

- *More Is Not Always Better.* There are areas of Los Angeles where an increase in density will not produce a feasible mixed-use project, due to limited market demand and low rents.

Changes to the Model for the Westside Cities Analysis. After carefully reviewing the details of The Natelson Company's model that was prepared for the City of Los Angeles General Plan Framework, the following changes were made for the Westside Cities version of the model:

- *More Detailed Cash Flow analysis.* A nine-month entitlements period was added prior to the start of constriction, during which all soft costs, except land purchase and 15% of architectural and engineering fees, were spread evenly. The cash flow analysis was also extended from eight to 10 years of project operation. Each site is assumed to be purchased, with 1% paid as an option in the month prior to commencement of the entitlements process, and the balance due in full at the start of construction.

- *Location-Specific Land Costs, Rents and Rent-related Assumptions.* Westside-specific values were derived from interviews with brokers and other real estate professions in each city who were familiar with market conditions in the area around each project example. These assumptions are shown in Appendix B.

- *Higher Subterranean Parking Construction Costs.* Average building construction cost was left at $70/s.f., but below-grade parking cost was increased from $25/sf for all subterranean levels to $30/sf for the first level and $35/sf for the second or third level.

- *Different Financing Assumptions.* Based on current market conditions and the HR&A project team's judgment, the following model parameters were also changed:

  -- The debt coverage ratio was increased from 1.10 to 1.25.

  -- The permanent loan term was reduced from 30 years to 25 years.

-- Capitalization rates were increased to 10%.

-- Present value discount rate and target IRR were increased from 12% to 15%.

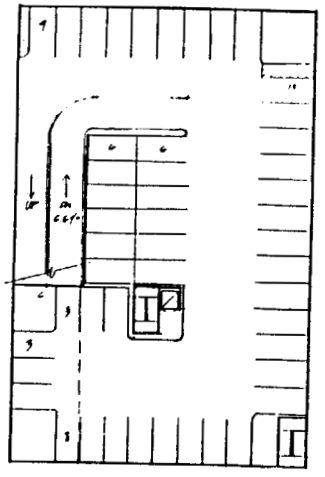
B. THE FOUR PROTOTYPE MIXED-USE PROJECTS

The planning and community development staff at each of the four Westside cities were asked to nominate a site where a mixed-use project was either actively under consideration, or might be proposed for future development, or where the city for other reasons was interested in testing the feasibility of such a project. The zoning regulations that would normally apply to a project on that site were then applied, and a graphic illustration of a conforming development project was then generated by the Metcalfe Associates. These illustrations provided the basis for estimating various physical parameters that were used in performing the financial feasibility tests. In addition, estimates were made of any applicable development fees and other related pre-construction development costs that were city-specific. A market reconnaissance was then performed to assemble city-specific land values, rents, and other financial factors specific to each city. These assumptions and others that applied across all of the prototypes were described in the preceding Chapter

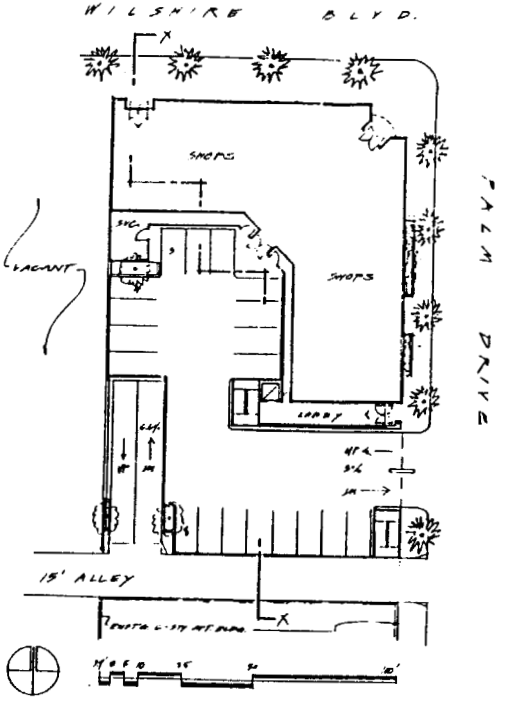
The Beverly Hills Prototype

- *Overview.* This prototype is located on a 100' x 160' (16, 416 s.f.) flat site at the corner of Wilshire Boulevard and Palm Drive. There is currently no provision in that city's zoning code for a mixed use project. However, it can be assumed that a discretionary review process would be required to approve it.

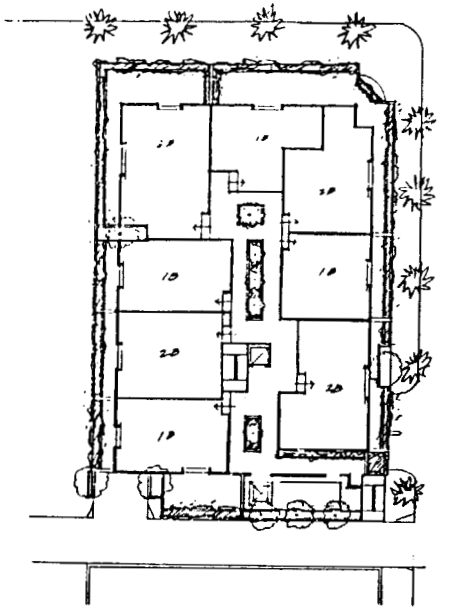
- *Zoning Issues.* The applicable zoning regulations which city staff indicated would apply for such a project allows a 45'-0" high building. This translated into about 7,000 gross square feet of retail on the ground floor and two upper floors of apartments (four one-bedroom and four two-bedroom units on each of two upper floors), as shown in Figure V-1. Gross Floor Area (GFA) of the building is 29,157 s.f., with a Floor Area Ratio (FAR) of 1.78. The ground floor retail



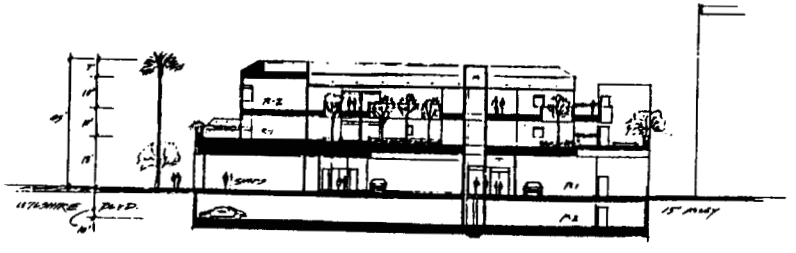
LOWER LEVEL PARKING: 98 CARS INCL. ADA STALLS
103.9' x 158' = 16,416.2 GSF = 342 GSF/STALL



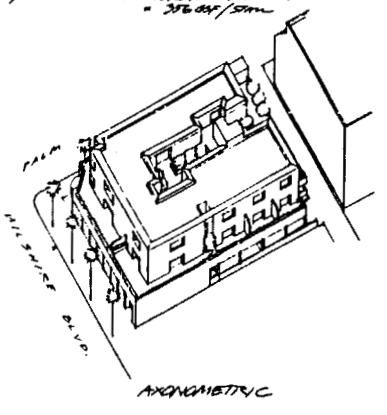
GROUND FLOOR: RETAIL AND PARKING
(11) PARKING SPACES IN PORTE COCHERE STREET LEVEL DECK
= 340 GSF/STALL. GR. AREA = 33,137.2 GSF ÷ 67 SPACES
= 376 GSF/STALL



TYPICAL UPPER RESIDENTIAL FLOOR PLAN
LEVEL R-1 BELOW SIMILAR W/ 8 D.U.



CROSS SECTION X-X



AXONOMETRIC

PROTOTYPE PROGRAM:

GROSS SITE AREA: 16,416.2 SF				.377 Acres
• RETAIL (STREET) LEVEL			GBA SF	GLA SF
SHOPS			6657	6524
• RESIDENTIAL	D.U.	NSA/UNIT		NLSF
R-1 & R-2 { 2 BDRM APTS.	4	1300	6138	4900
R-2 { 1 BDRM APTS.	4	1000	5112	4000
SUB-TOTAL TYP. FLOOR:	8		11,250	8900
SUB-TOTAL RESIDENTIAL:	16		22,500	17,600
TOTAL DEVELOPMENT:	16 D.U.		29,157 SF	24,124 SF
F.A.R. = 1.8			FLOOR RATIO: .60	
• PARKING				SPACES
PARKING PROVIDED FOR RETAIL @ 4.1/1000 SF GLA =				27
" " " RESIDENTIAL @ 2.5/D.U. =				40
TOTAL PARKING PROVIDED:				67

MIXED-USE DEVELOPMENT PROTOTYPE for THE CITY OF
BEVERLY HILLS

JOHNSON, FAIRCHILD & WEAVER • METROPOLITAN ASSOCIATES
AUGUST 1980

FIGURE V-1

is placed at the property line along Wilshire and Palm. The entrance and elevator lobby for the upper floor residential use is located on the Palm Drive side at the terminus of the retail space. The two residential floors are double-loaded around a central court yard, and are set back from the perimeter of the retail space below to provide each unit with outdoor patio area.

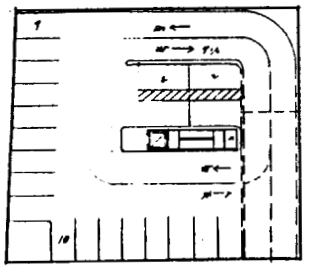
- *Parking.* This prototype would require a total of 67 parking spaces, which would be accommodated on two subterranean levels (24 spaces each) and 19 street-level spaces at the rear of the retail spaces, accessed from Palm Drive. The subterranean levels would be accessed from the alley behind the project. Of the total parking supply, about two-thirds of the spaces are for the residential use (2.5 spaces per unit) and one-third for the retail use.

- *Development Fees.* Customary development fees (i.e., in addition to discretionary permit processing fees, building permit fees and public works fees) that would apply in this case include a 1% Fine Arts Fee; a school impact fee; a dwelling unit tax; and open space fee. Total cost of fees is estimated at $215,642.

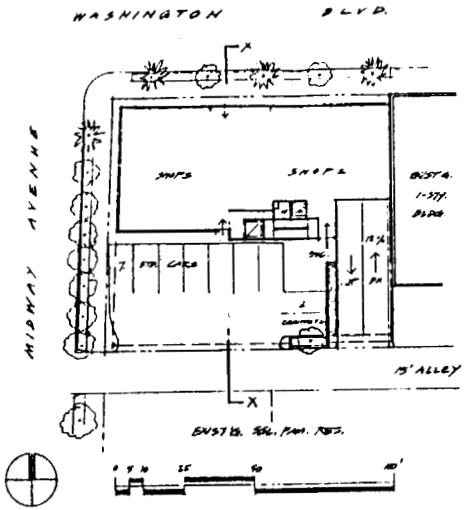
The Culver City Prototype

- *Overview.* This prototype applies to a 100' x 100' flat site (9,192 s.f.) on Washington Boulevard at the corner of Midway Avenue. The City has no special permit process for mixed-use development, and this prototype would involve a discretionary density bonus application for the residential use to exceed the base density allowed.

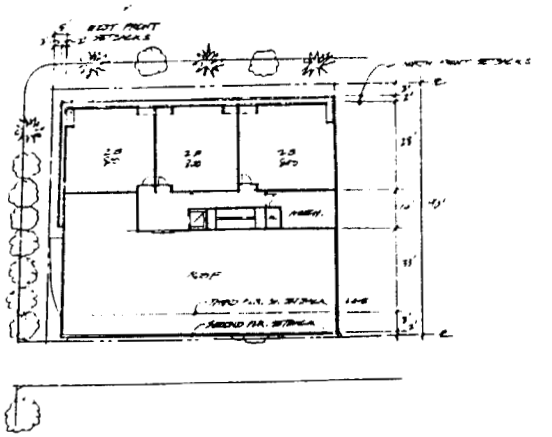
- *Zoning Issues.* The zoning regulations applicable to this site permit a 56'-0" high building, but due to limits on allowable density bonus for residential uses, and current market conditions, a three-story (46'-0" high) configuration is the most likely result. City staff advised that, based on past practice, the residential density bonus should be limited to 50% and that the bonus units should be designated for seniors. This, in combination with the otherwise applicable setback and other zoning standards, results in a development concept of about 15,800 gross square feet. It includes about 4,300 gross s.f. of ground floor retail along the Washington Boulevard frontage, a full second floor of six market rate rental units (three one-bedroom units and three two-bedroom units), and a partial third floor with three smaller two-bedroom units for seniors.



- P-1 PARKING LEVEL: 21 STALLS INCL (1) ADA
  100' x 104.33' x 76' = 9772.15 GSF
- P-2 LOWER LEVEL = 6176 GSF: 10 STALLS (PARTIAL FLOOR)
  TOTAL SUBTERRANEAN PKG.: 31 STALLS @ 496 GSF EA.



GROUND FLOOR: RETAIL and PARKING



ROOF PLAN: UPPER FLOOR R-2

SENIORS UNITS: (3) 2 BDRM. @ 800 SF EA.

R-1 MIX FLR. BELOW w/ 6 ASST. MIX DWELLING UNITS (SIMILAR LAYOUT w/DIFF. UNIT PLANS)

PROTOTYPE PROGRAM:

GROSS SITE AREA: 9772.15 SF = .21 Acres

			GSF SF	GLA SF
• RETAIL (STREET) LEVEL				
SHOPS			7276	3878
• RESIDENTIAL	D.U.	NSF/UNIT		NLSF
R-1 1 BDRM. APTS.	3	1000	3695	3300
2 BDRM. APTS.	3	1200	4439	3600
SUB-TOTAL R-1:	6		8134	6900
R-2 SENIORS				
2 BDRM. APTS.	3	800	3408	2400
TOTAL RESIDENTIAL:	9		11,542	9300
TOTAL DEVELOPMENT:			18,830 SF	12,878 SF

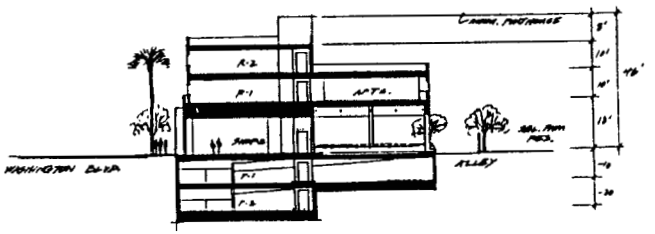
F.A.R. = 1.72 HOUSING RATIO: .97

• PARKING

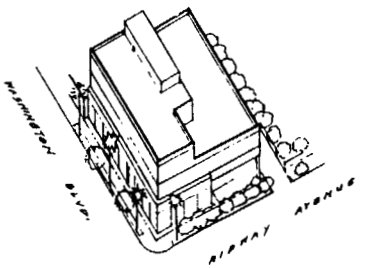
PROVIDED FOR RETAIL ON GRADE:	9 CARS
ON P-1 SUBTERRANEAN:	6
SUB-TOTAL FOR RETAIL @ 1/363 SF GLA =	15
FOR 1 BDRM. D.U. (3) @ 2/D.U. (ALL SUBTERRANEAN) =	6
FOR 2 BDRM. D.U. (6) @ 2.5/D.U. (" ") =	15
SUB-TOTAL FOR RESIDENTIAL =	21
TOTAL PARKING REQUIRED:	36
TOTAL PARKING PROVIDED:	40

MIXED-USE DEVELOPMENT PROTOTYPE for THE CITY of CULVER CITY

HAMILTON, MASINVITA KRAMMER = METCALFE ASSOCIATES
SEPTEMBER 1995



CROSS SECTION X-X: VIEW EAST



AXONOMETRIC

FIGURE V-2

Access to the residential space is via an elevator lobby off the Midway side of the building, behind the retail space. The prototype's FAR is 1.72. A graphic interpretation of these standards is shown in Figure V-2.

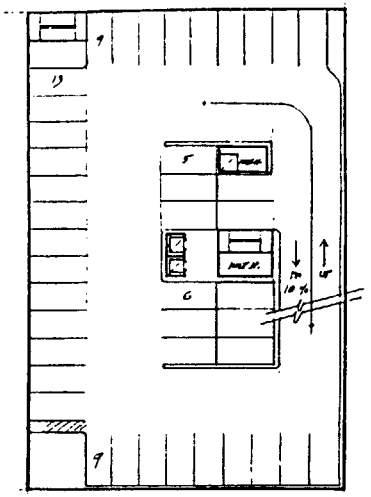
- *Parking.* A total of 36 parking spaces would be required for this development concept; 40 are provided. Seven at-grade spaces are located behind the ground floor retail space, with the balance in a subterranean garage that is one and one-half levels below grade. About 40 percent of the parking is required for the retail use and 60 percent for residential (2.0 spaces per unit for the one-bedroom units; 2.5 spaces for the two-bedroom spaces; no discount for the smaller seniors units).

- *Development Fees.* This city's development fees that would apply to a project like the prototype include a 1% art fee; a school fee; a residential and non-residential surcharge; a new development fee and an open space fee. Total cost of fees is estimated at $48,302.

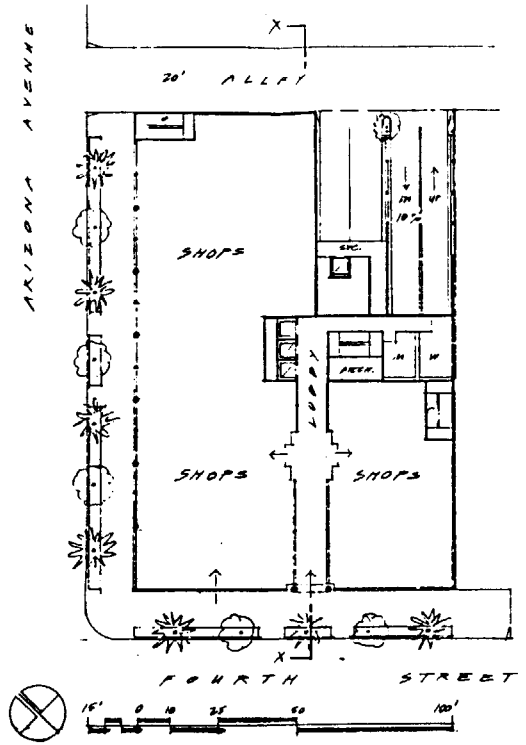
The Santa Monica Prototype

- *Overview.* This prototype is located on a 100' x 150' (15,000 s.f.) flat site at the corner of Fourth Street and Arizona Avenue. This is one block east of the Third Street Promenade, and within the boundaries of a pending expansion to the Bayside District Specific Plan, which now covers the Promenade.

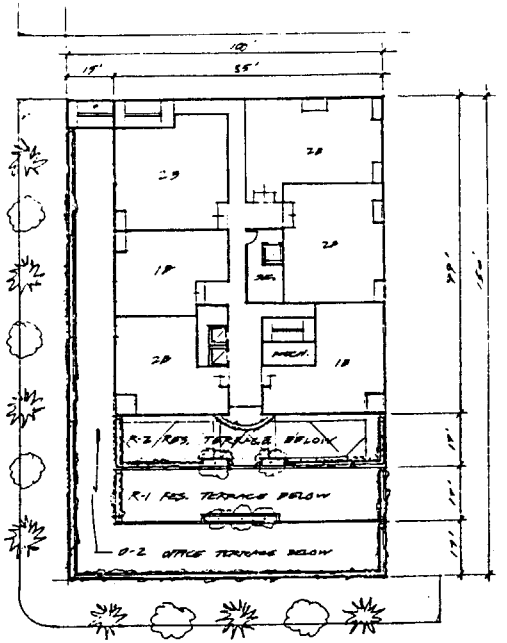
- *Zoning Issues.* The applicable zoning standards would permit an 84'-0" (six stories) high building with 17-foot wide upper story setbacks on each floor above 30 feet on the Fourth Street elevation. At the City staff's request, an additional 15-foot wide upper story setback was included on the Arizona side, which is an urban design standard now under consideration for the Specific Plan Amendment. The use mix includes non-restaurant retail on the ground floor, multi-tenant commercial office space on the second floor, and three upper floors of apartments (five one-bedroom units and 14 two-bedroom units). Access to the upper floor office and residential space is from an elevator lobby accessed from a Fourth Street entrance, with two elevators dedicated to the residential floors and one for the office floor.



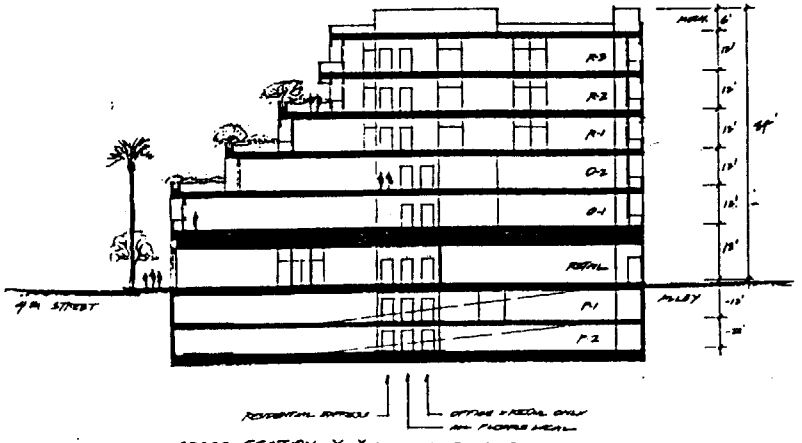
TYPICAL PARKING LEVEL: 92 STALLS INCL. ADA
100'x150' = 15,000 GSF/LEVEL P2 W/ 99 STALLS
(2) LEVELS = 30,000 GSF
TOTAL PARKING PROVIDED = 86 STALLS = 347 GSF/STALL



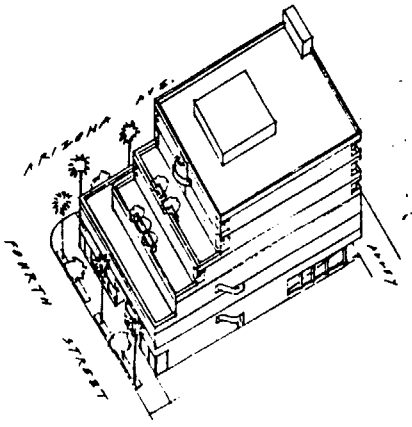
GROUND FLOOR: RETAIL



TYPICAL UPPER RESIDENTIAL FLOOR PLAN
FLOORS R-2 & R-3 W/ G.A.U. REQ. + R-1 W/ T.D.R.



CROSS SECTION X-X: VIEW NORTH-WEST



AXONOMETRIC

PROTOTYPE PROGRAM:

GROSS SITE AREA: 16,100 SF .34 Acres

			GBA SF	GLA SF
• RETAIL (STREET) LEVEL				
ARIZONA FRONTAGE:			7,713	7542
FOURTH STREET FRONTAGE:			2680	2398
SUB-TOTAL RETAIL:			10,393	9940
• OFFICE			GBA SF	NUSF
LEVEL O-1	(80'x150')		14,619	11,849
LEVEL O-2	(85'x133')		11,116	8294
SUB-TOTAL OFFICE:			25,735	20,143
• RESIDENTIAL	D.U.	NSF/UNIT	GBA SF	NSF
LEVEL R-1 (85'x116' Gross)	6	1200	9860	8200
	1	1000		
LEVELS 2 R-2 & R-3 (85'x99' Gross ea.)	8	1200	16,830	13,600
	4	1000		
SUB-TOTAL RESIDENTIAL:			26,690	21,800
TOTAL DEVELOPMENT: 19 D.U.			62,818 SF	51,883 SF

F.A.R. = 36,185SF + ½ RES. 13,345 = 49,473/15,000 SF = 3.0
HOUSING RATIO: .35

• PARKING	SPACES
PROVIDED FOR RETAIL @ MUNICIPAL PUBLIC STRUCTURE 4TH STREET	
" " OFFICE @ 1.5/1000 NUSF (1.5 in " "	30
" " RESIDENTIAL @ 2.9/D.U. =	56
TOTAL PARKING PROVIDED ON (2) DECKS BELOW GRADE:	86

MIXED-USE DEVELOPMENT PROTOTYPE for THE CITY OF

SANTA MONICA

HAMILTON, RABINOVITZ & ALSCHULER • METCALFE ASSOCIATES
AUGUST 1995

FIGURE V-3

Total floor area is about 62,800 gross square feet, for an FAR of 3.0 (including the City's FAR calculation rule under which residential floor area is counted at half its actual space). The upper floor setbacks prevented reaching the maximum allowable FAR of 3.5. Figure V-3 shows one graphic interpretation of these standards. The prototype also include this City's requirement that 30% of the dwelling units be rented at prices affordable to low- and moderate-income households.[57]

- *Parking.* The site is located within the boundaries of a downtown parking assessment district, and therefore all non-residential parking could theoretically be accommodated in the adjacent public parking structures. The HR&A project team believes, however, that some on-site parking for the office tenants would also be required to meet market expectations. Accordingly, 30 spaces are included on site for office tenants (at about half the rate normally required by the City), and another 56 per zoning code requirements, in two subterranean parking levels. The retail parking requirement is presumed to be accommodated in the City's structures.

- *Development Fees.* Development fees that would apply in this case include a school fee; housing/parks mitigation fee on the office space; and a recreation tax on each dwelling unit. Total cost of fees is estimated at $185,051.

The West Hollywood Prototype

- *Overview.* This prototype is located on a downward sloping site on the south side of Sunset Boulevard, between Hammond Street and Hilldale Avenue. It is within the boundaries of the recently adopted Sunset Boulevard Specific Plan, and would be subject to its urban design guidelines. These include a "view corridor" through the site, which was interpreted as an extra wide setback along the Hilldale side.

[57] Technically, an in lieu fee payment is available for the low-income units, but the moderate-income units must be provided on site.

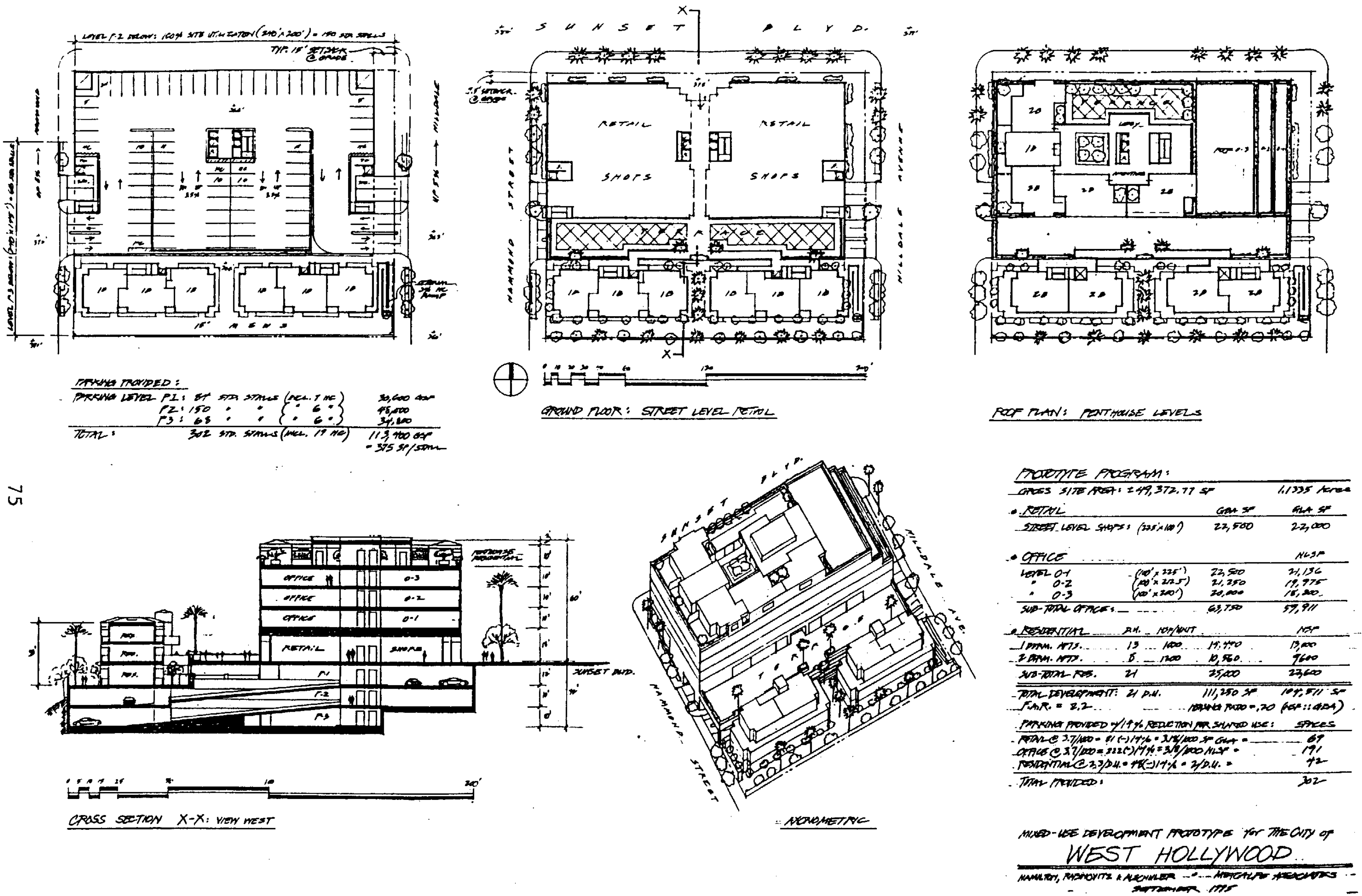

SUNSET BLVD.
RETAIL
SHOPS
HAMMOND STREET
HILLDALE AVENUE
PARKING PROVIDED:
GROUND FLOOR: STREET LEVEL RETAIL
ROOF PLAN: PENTHOUSE LEVELS
CROSS SECTION X-X: VIEW WEST
AXONOMETRIC
PROTOTYPE PROGRAM:
GROSS SITE AREA: ±49,372.77 SF
1.1335 Acres
RETAIL
STREET LEVEL SHOPS: (225'x100')
22,500
22,000
OFFICE
LEVEL O-1
O-2
O-3
SUB-TOTAL OFFICES:
63,750
57,911
RESIDENTIAL
SUB-TOTAL RES.
25,000
TOTAL DEVELOPMENT: 21 D.U.
111,250 SF
F.A.R. = 2.2
PARKING PROVIDED w/19% REDUCTION FOR SHARED USE:
SPACES
TOTAL PROVIDED:
302
MIXED-USE DEVELOPMENT PROTOTYPE for THE CITY of
WEST HOLLYWOOD
SEPTEMBER 1995

FIGURE V-4

- *Zoning Issues.* The applicable zoning standards would allow a 60'-0"(five story) building fronting Sunset, and two separate 33-foot (three story) residential structure on the rear, down slope portion of the site across an outdoor terrace from the commercial structure. The Sunset Boulevard building would have about 22,500 gross square feet of ground floor retail space, about 63,800 s.f. of office space on three upper stories, and a residential penthouse level with four two-bedroom and one one-bedroom units, positioned to take maximum advantage of hillside and long distance city views. A central elevator bank would serve the upper floors, with two elevators dedicated to the office floors and two to the residential penthouse. The separate apartment structures include 16 one- and two-bedroom units.

  In keeping with City requirements, 20 percent of the dwelling units were designated for rent to lower-income households. Gross floor area is 111,250 s.f., for an FAR of 2.2. Figure V-4 presents a graphic interpretation of these standards.

- *Parking.* Total on-site parking is provided for 302 vehicles, which assumes the project would be granted a 14% "shared use" reduction, per City regulations. About one-quarter of the spaces are for the retail space, about two-thirds are for the office space and the balance is for the dwelling units. All parking is accommodated on two and one-half levels below grade, oriented to take advantage of the site's downhill slope. Access to the parking is from the two side streets.

- *Development Fees.* This city's development fees include a school fee; affordable housing, parks and child care impact fee on the office space; transportation impacts fee; and a 1% for arts fee.

C. FEASIBILITY RESULTS

The Baseline Feasibility Results. Using the 15% Internal Rate of Return (IRR) threshold for feasibility, which reflects the higher level of risk associated with this type of development, none of the four Westside prototype mixed-use projects would be considered "feasible." The IRRs, and various project parameters, for the four prototypical projects are shown in Table V-1, below. Prototype-specific model inputs are included in Appendix B; 10-year cash flow statements are included in Appendix D.

Table V-1
Internal Rates of Return for Four Prototypical Mixed-Use Development Projects in the Westside Cities Subregion -- The Base Case

VARIABLE	BEVERLY HILLS	CULVER CITY	SANTA MONICA	WEST HOLLYWOOD
IRR	4.06%	-6.64%	8.91%	6.19%
Floor Area (g.s.f.)	29,157	15,820	62,818	111,250
Floor Area Ratio	1.80	1.72	3.00	2.20
Commercial Floor Area (g.s.f.)	6,657	4,278	36,128	86,250
Residential Floor Area (g.s.f.)	22,500	11,542	26,690	25,000
# Residential Units	16	9	19	21
Total Parking (# spaces)	67	40	86	302
Parking Levels Below Grade	1	1.5	2	3
Land Cost ($/s.f.)	$110.00	$51.66	$86.66	$75.00
Retail Rent ($/s.f./mo. NNN)	$2.35	$1.40	$1.75	$2.25
2-Bedroom Monthly Rent (Market Rate)	$1,400	$1,000	$1,300	$1,250

Source: HR&A

Feasibility Under Each of Several Change Options. The HR&A project team then evaluated a set of strategies that are within the power of the cities to effect, to test the degree to which they might improve each prototype's rate of return. The following table summarizes the results of this investigation when each change is applied, one at a time:

Table V-2.
Effects of Various Public Sector Strategies That Could Improve the Internal Rates of Return for Four Prototypical Mixed-Use Development Projects in the Westside Cities Subregion

STRATEGY	BEVERLY HILLS	CULVER CITY	SANTA MONICA	WEST HOLLYWOOD
Base Case	4.06%	-6.64%	8.91%	6.19%
Waive All City "Mitigation" Fees Except School Fees	4.60%	-6.24%	9.89%	7.00%
Reduce Parking Requirement 50%	5.24%	-4.03%	11.45%	9.85%
Increase Allowable Floor Area Ratio 50%	9.80%	-12.07%	13.70%	7.37%
Write Down Land Cost				
25%	5.98%	-5.53%	10.62%	8.37%
50%	9.06%	-4.55%	11.90%	10.01%

Source: HR&A

Implications of the Sensitivity Analysis

Some implications of these results, in order of their potentially beneficial results, are:

- *Additional Floor Area.* Among the strategies tested, increasing allowable floor area would be most helpful to the examples in Beverly Hills and Santa Monica, but less helpful to the West Hollywood example, and it adversely affects the Culver City example because the additional construction cost overwhelms the additional rent income. This reflects the relatively better trade-off between extra development costs and achievable rents in Beverly Hills and Santa Monica. Also in Santa Monica's case, the ability to use an off-site parking resource in lieu of on-site subterranean parking makes this strategy even more helpful to the IRR.

- *Reduction in Land Cost.* Large land write-downs, or other strategies that reduce land costs would also help in all cases, but again to different degrees in each city. Beverly Hills' and West Hollywood's examples would benefit the most among the four.

- *Reductions in On-Site Parking Requirements.* Parking reductions help about as much as land cost reductions in most cities.

- *Reductions in Fees.* Waiving "mitigation" fees (not including school fees and building permit and related fees) helps only marginally.

- *Reductions in Permit Processing Time.* Reducing discretionary permit processing time below the assumed 9-month period in the base cases, although not specifically tested, is another possible tactic for improving project feasibility. Here again, it would help (i.e., by reducing "holding" costs), but not to as great a degree as other strategies.

Although no single strategy alone was sufficient to reach the 15% IRR threshold, combinations of strategies would probably get the Santa Monica example over the hurdle. Beverly Hills and West Hollywood could get within striking distance. No combination of strategies, including free land, will work for the Culver City example based on the parameters used in the prototype.

VI. RESPONSES TO ISSUES RAISED BY THE CASE STUDIES AND THE PROTOTYPE MIXED-USE PROJECTS

This Chapter summarizes some of the lessons gleaned from the case studies presented in Chapter IV and the prototypical projects described in Chapter V, which bear on the issue of what the Westside cities might consider doing or changing about their development standards, project review and approval procedures, or other regulations or actions, in order to facilitate future mixed-use projects.

A. THE ENTITLEMENTS PROCESS AND DEVELOPMENT REGULATIONS

Establishing Clear Review Criteria and Timely Processing of Discretionary Permits. Mixed-use projects are atypical, and often require major to minor changes to standard development regulations for the zoning district in which they are proposed. The additional time that may be needed to obtain required approvals adds to the cost of these projects, whose financial structures are unusually precarious. In light of how quickly market conditions can change, delays in the approval process can delay project completion to the point that it misses the market for which the project was intended.

Possible City Responses:

- *Standardize Review Procedures.* Cities should consider either (a) making mixed-use a permitted use in certain zoning districts and allowing projects to be developed as-of-right; or (b) developing a set of development performance standards for mixed-use projects, such that a project conforming to the standards could be approved with minimal discretionary review.

- *Consolidate Discretionary Reviews.* To the extent that General Plan revisions, zone changes, conditional approvals, variances, use permits and/or other special exceptions are needed, these approvals should be processed concurrently rather than sequentially.

- *Focus Environmental Assessments and Standardize Mitigation Measures.* Consideration should also be given to conducting a master environmental assessment of the mixed-use product type, so that to the extent an individual project requires environmental assessment, it can be narrowly focussed on site-specific issues. Standardizing mitigation measures will help ensure that the cities' expectations, and the costs thereof, are understood at the outset.

In Setting Basic Project Review Criteria, Consider the Scale That Mixed-Use Projects Typically Need in Order to Be Viable. Although a few small, one- or two-lot, mixed-use projects may be feasible under specific circumstances (e.g., self-financed), projects with a meaningful mix of uses and a high level of quality will more likely involve larger sites and bigger buildings to achieve necessary economies of scale commensurate with the level of risk involved in such projects. The relatively low densities permitted on the Westside adversely impact project economics (see Chapter VI). This could cause projects to chase only the highest possible rents and sale prices, which could preclude or limit neighborhood-serving retail uses and household with more modest incomes.

Further, the Westside's typical 45-foot height limit makes it difficult to (a) provide interior ceiling heights desired by larger retail tenants without short-changing floor-to-ceiling heights for the residential uses above the commercial uses; and (b) incorporate density bonuses, where applicable.

Possible City Responses:

- *Anticipate That Overall Project Scale Will Be Large, By Westside Standards.* In setting review thresholds like those noted above, the cities should recognize that successful mixed-use projects will probably need to be in a range of 100,000 square feet to be financially viable developments and to attract appropriately sophisticated developers and lenders. In the Westside cities, this is a project that would typically require considerable discretionary review.

- *Permit Higher Residential Densities and Smaller Units Sizes.* The cities should consider allowing mixed-use projects to have dwelling unit densities up to 80 units per acre in order to create more interesting urban environments, permit a wider range of incomes and generate sufficient return on investment. Higher densities can be achieved without significantly enlarging the building envelope if smaller unit sizes are permitted (e.g., one-bedroom units at 500 s.f. and two-bedroom units at 800 s.f.).

- *Be Flexible With Open Space Requirements.* The cities should be flexible regarding how and where open space requirements can be met in order to accommodate increased densities. Consider courtyards, balconies, terraces and rooftops in addition to setbacks from property lines.

- *Be Flexible With Building Heights When Mixing Residential With Other Uses.* The cities should consider allowing building heights for the residential component of

mixed-use projects to exceed otherwise applicable building heights in order to: (a) accommodate the different floor-to-ceiling heights of retail and residential uses; and 2) enable architects the flexibility needed to accommodate and express the different needs of the project's land uses.

- *Consider Density Bonuses for Preferred Uses, But Require Substantial Commitments to Those Uses.* Cities should consider granting development envelope bonuses (e.g., extra height or floor area) for preferred uses (e.g., residential or pedestrian-oriented ground floor commercial uses). But, to avoid introducing distortions in the market, the cities should require more than token commitments to such uses in order to qualify for the bonus.

Avoid Overburdening Mixed-Use Project With Unnecessary and Very Costly Parking Requirements. Parking costs, and particularly subterranean parking that is required for most Westside projects, is one of the most expensive components of a mixed-use project. Mixed-use projects generally do not need the amount of parking typically required for each use considered separately. In addition, available evidence suggests that dwelling units dedicated for lower-income households require less parking than market rate units.

Possible City Responses:

- *Allow for Parking Reductions Based on a Project-Specific Shared Use Parking Analysis.* Allow mixed-use projects to apply for parking reductions that recognize unique features of mixed-use projects, such as: (a) alternating hours of operation and occupancy for the various uses; and (b) proximity of public parking facilities and/or public transit.

- *Allow Subterranean Parking to Extend Into Rights-of-Way.* Consider allowing (perhaps for a fee) subterranean parking to extend beyond the property line under the public right-of-way (alley or street) in order to help minimize the number of subterranean parking levels.

- *Maximize Compact Spaces and Tandem Parking.* Allow upwards of 50% of required spaces to be compact spaces, and permit parking attendants to stack vehicles in parking aisles during peak use hours. Allow tandem parking for residential units to reduce circulation area and maximize the number of parking spaces.

- *Lower Parking Requirement for Dedicated Affordable Units.* Reduce the resident and/or guest parking requirements for units restricted for occupancy by lower-income households.

B. BUILDING CODES AND THE CONSTRUCTION INSPECTION PROCESS

Resolving Code Interpretation Conflicts That Are Particularly Problematic In Mixed-Use Projects. For any project, the building construction inspection process can cause significant unanticipated costs. These costs include required construction modifications and inspection delays while interpretation conflicts (either inter-departmental or between developer and city) are resolved. These problems arise when there is high turnover among inspectors, each of whom may have a different interpretation of the building code and/or interpretations that differ from the city inspector who signed off on the construction plans. Mixed-use projects often involve particularly complicated code interpretations where these coordination problems can be exacerbated. Recurring code interpretation conflicts for mixed-use projects include: 1) fire ratings for courtyards and exterior walls; 2) types of permitted construction; 3) exit stair requirements; and 4) separation requirements between residential and non-residential uses.

Possible City Responses:

- *Adopt Code Amendments to Address Predictable Conflicts.* Anticipate potential code conflicts related to mixed-use development and determine generic solutions and/or adopt code exceptions for mixed-use projects as appropriate.

- *Early Agreement on the Ground Rules.* Create an opportunity early in the development process whereby the various city departments can agree on the ground rules by which the mixed-use building is to be designed. Include upper level staff in these preliminary design meetings to ensure that the agreement(s) get carried out accordingly.

- *Achieve Consistency in Field Interpretations.* Create an inspection approval process that, in the case of inspector turnover, does not require significant reconstruction of particular project components once they have been approved by a prior inspector.

C. MARKETING ISSUES

Do Not Expect Mixed-Use Projects to Swim Against the Stream Successfully. The Westside cities should not expect mixed-use projects to be effective catalysts for revitalizing redevelopment, transitional or other marginal areas. They should respond to market demand, but cannot create it. Under current Westside density and height limits, mixed-use projects need to achieve relatively high commercial and residential rents. Such projects will only be viable, therefore, in established areas where people want to live, where tenants want to locate and where there is already high foot traffic. Mixed-use projects intended for redevelopment areas characterized as marginal or transitional will typically have a more difficult and lengthy lease-up period.

Possible City Responses:

- *Additional Incentives Need to Be considered for Marginal Areas.* Mixed-use projects in marginal areas will require public subsidies -- i.e., land write-downs, tax abatements, low cost financing and related public investments -- to counterbalance the market rent limitations of marginal areas. If the redevelopment works in the long run, cities will recapture their investments through tax revenue increases and/or a negotiated share in the appreciated value they helped to create. Any such public subsidies and assistance must, however, be appropriate in amount and duration to realistically accommodate the time and tenant improvements necessary to achieve stabilized lease-up at market rents.

The Retail Component of Mixed-Use Projects is the Biggest Leasing Challenge. Markets change in response to shifts in the economic climate over the life of the development process. The impact of market changes on mixed-use projects is compounded by the fact that this product type involves multiple markets and market cycles. Code requirements and project conditions which define too narrowly the permitted residential and commercial uses may prove unworkable. Building design elements that block or obscure street visibility of the storefront, or overly restrictive signage requirements, can create resistance among retailers to locate in a mixed-use project. Retail storefronts in the middle portion of the building are usually more difficult to lease than corner storefronts because of street visibility and identity. Appropriate retail storefront depths and easily accessible parking, in addition to traditional signage opportunities, can help mitigate a mid-building storefront location.

Possible City Responses:

- *Be Flexible When Specifying Desired Uses.* The cities should be flexible in defining acceptable commercial or residential uses, allowing the project to respond to changing market conditions.

- *Adjust Design Standards to Market Realities.* Design and signage criteria and requirements should be developed to meet the needs of traditional retailers. Cities should allow for flexibility in the design of the ground floor level of mixed-use projects so they can accommodate appropriate retail storefront depths and accessible parking.

Mixed-Use Projects Cannot Resolve Conflicts Between Markets and Competing Public Policies. Given the marketing complexities of mixing uses in a single project, cities should be cautious about imposing additional conditions to achieve numerous city policy objectives in these projects. For example, requirements for on-site, mixed-income family housing and large family units, needed though they may be, present significant marketing obstacles under the best of circumstances, and can present insurmountable obstacles for mixed-use projects. Requirements to provide for-sale housing in combination with rental housing, whether price-restricted or market rate, reduce the ability to secure bond financing, which is a major source of rental housing project financing. When rent- or for-sale-restricted units are required to be designed and built to exactly the same standards as a project's market units, and/or are required to be uniformly located throughout the building, the project loses the opportunity to balance development costs and potential revenues.

Possible City Responses:

- *Set Clear, Internally Consistent Policy Priorities for Mixed-Use Projects.* The Westside cities may not be able to achieve all of their policy objectives in every project; choices between promoting mixed-use development for its own sake and other objectives may be necessary. Offsetting incentives, bonuses or flexibilities should be available when a city seeks to achieve multiple, competing objectives.

- *Keep It Simple.* Avoid requirements to provide rental and for-sale housing within the same project unless financing is available for both housing types and can be secured at terms reasonable for the project. If mixed-income housing is to be required in mixed-use projects, cities should avoid overly restrictive requirements on the comparability of features and unit location.

D. FINANCING ISSUES

Cities Are Generally Unfamiliar With Lender Requirements and Impacts of City Regulations on Lending Decisions. Mixed-use projects, especially those with a price-restricted rental or for-sale housing component, typically involve multiple sources of debt financing and subsidy. The requirements of various lenders can often be in conflict with one another and with the requirements of the local jurisdiction. This adversely impacts the ability of the developer to satisfy the requirements of and/or the negotiated agreements with lenders and the local jurisdiction.

For mixed-use projects in which cities provide financing or other assistance, lenders prefer that the public contribution take a form that can be provided or paid in during project development (e.g., public improvements), rather than a form of assistance that occurs during the operational phase (e.g., rent subsidies). Lenders are uncomfortable with the political uncertainties associated with public sector project assistance in general, and with long-term public sector assistance in particular.

Possible City Responses:

- *Consider the requirements of loan programs and their lenders when establishing project conditions and requirements.* The Westside cities need to develop a better understanding about how their requirements (codes, designs, exactions) affect the lender's decisions and parameters for making construction and permanent loans. Where possible, cities should provide opportunities to seek alternative solutions and/or compromises to local requirements that may be in conflict with lender requirements or adversely impact costs to the point of jeopardizing the project's financing. Alternatively, financing assistance should be provided to projects when above-average amenities or other city policy objectives add significant costs to a mixed-use project that cannot be supported by market rents.

- *Focus City Assistance on the Development Phase.* When evaluating opportunities to provide public assistance for a mixed-use project, cities should focus on assistance that can be provided during the development phase of the project.

Time Is Money. The release of funds by lenders to developers to pay for up-front project costs, including land acquisition and pre-development expenses, is often tied to receipt of public approvals for the project. Long delays in the public approval process can increase land carry and pre-development costs (and hence equity requirements), and deplete the

developer's pre-construction resources, resulting in abandonment of the project. This may also result in a much shallower pool of developers willing to pursue a mixed-use project.

Possible City Responses:

- *Create an Expedited Permit Approval Process for Mixed-Use Projects.* For this additional reason, the Westside cities should consider developing a process by which the time required to obtain public approvals is more reliable and shorter, provided the applicant's submittals are complete and within established or negotiated parameters.

Lender Requirements Dictate Project Parameters. Lenders are less familiar with mixed-use as a product type than they are with more traditional residential and commercial uses. They typically discount loan amounts and set lower loan-to-value limits due to the higher level of risk they associate with mixed-use projects. Developers, therefore, are generally required to invest more equity than they typically would for single-use projects, must show evidence of unusually high pre-leasing or sales commitments, and are usually required to provide substantial financial statements and personal guarantees. These financial requirements limit the type of developer who can secure financing for mixed-use projects and increases the threshold project size necessary to generate an acceptable return on investment.

Possible City Responses:

- *Learn About Lenders' Needs.* The cities should discuss their commitment to mixed-use development with their local lending community. Together, they should seek ways to create a market context that supports mixed-use projects, and find ways to anticipate and accommodate each other's objectives.

Westside Land Prices Adjust Unusually Slowly in Response to Market and Regulatory Changes. High land cost is a persistent and significant problem for development on the Westside in general, and for riskier product types, such as mixed-use development, in particular. Some land owners have unrealistic expectations regarding the value of their property. They are not willing to sell their land or enter into a joint venture development because they are unwilling to accept a lower land value that more correctly reflects changes in the economy or more restrictive changes in land use regulations.

Possible City Responses:

- *Provide Information to Land Owners and Develop Assistance Programs.* Target those areas where the cities want to encourage mixed-use development and work with developers and land owners to achieve mutually acceptable land values through a program of public assistance and/or acquisition and public education.